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***Smith v. Van Gorkom* Revisited: Lessons Learned in Light of the Sarbanes-Oxley Act of 2002**

*Florence Shu-Acquaye**

I. INTRODUCTION

The 1982 case, *Smith v. Van Gorkom*,¹ was a landmark decision in the United States as it demarcated the requisites for a breach of the fiduciary duty of care. The Delaware court found the board liable solely for breach of its fiduciary duty of care to the corporation and hence liable in damages to the plaintiff shareholders.² Prior to this decision, courts were very reluctant to hold boards liable for a breach of their fiduciary duty of care, if the directors acted in good faith, in the best interest of the corporation, and its decisions were not tainted by fraud, illegality, or loyalty violations. Cases such as *Dodge v. Ford Motor Co.*,³ *Shlensky v. Wrigley*,⁴ and *Joy v. North*,⁵ evidence this precedent.

Van Gorkom, unlike the Enron case and its progeny, involved no loyalty violations, fraud, or illegality on the part of the board of directors and management, presupposing similar outcomes. Instead, the board of directors was found to have breached its fiduciary duty of care, thereby losing the protection of the business judgment rule presumption and sending shockwaves through corporations across the country. As a result, judges were urged to limit the applicability of their decision to the facts of the case. Also, State legislatures were lobbied to enact exculpatory provisions that limited or eradicated directors' liability for breach of its fiduciary duty of care; consequently, insurance for directors and officers alike skyrocketed.

If the *Van Gorkom* decision had any impact in deterring management and directors from negligent decision-making, then that decision, as well as subsequent decisions, state statutes, and rules of

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1. 488 A.2d 858 (Del. 1985).

2. *Id.* at 864.

3. *Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919).

4. *Shlensky v. Wrigley*, 237 N.E.2d 776 (Ill. App. Ct. 1968).

5. *Joy v. North*, 692 F.2d 880 (2d Cir. 1982).

corporate governance developed thenceforth, would have effectively averted the recent wave of corporate scandals. Is the answer to be found in a new law such as the Sarbanes-Oxley Act of 2002 ("Act")?⁶ How different is this Act from the current laws dealing with corporate governance of boards of directors? Will this Act redress the prevailing flaws in corporate governance policy?

Revisiting the case of *Van Gorkom*, in light of the Act, would reveal any such distinctions and any evolution of the laws in corporate governance. Also, assessing the role of each of the players in the case and determining their individual liability under the Act would highlight any similarities, as well as distinctions in the Act with prior laws.

This article critically evaluates the *Van Gorkom* decision by examining the overall conduct of the board of directors and management and the corresponding effect on the fiduciary duty of care owed to the corporation. The article also explores how the outcome of that decision could have been influenced by various provisions of the Act. For example, section 301 of the Act requires that companies listed with the New York Stock Exchange ("NYSE") and the National Association of Securities Dealers Automated Quotation ("NASDAQ") engage an audit committee comprised solely of independent directors. Also, section 305 of the Act expands the Security Exchange Commission's ("SEC") ability to remove directors and officers and bar them from serving in similar capacities at other public companies by demonstrating their "unfitness to serve." (The standard held prior to enactment of the Act only required "substantial unfitness.")

The NYSE also proposed additional amendments that would have been compulsory for companies listed on the NYSE, which had the potential to significantly affect corporate governance as we know it; this included the requirement that an independent board of directors be appointed. The effect of the relevant amendments is also addressed in this article.

Likewise, recent trends in exculpation provisions that limit or eliminate directors' liability for breach of the fiduciary duty of care are also examined. Presumably, these trends contributed significantly to the determining characteristics of the new corporate governance policy in the United States. Moreover, it has been said that the defining tension in corporate governance is that between deference to directors' decisions and the scope of judicial review.⁷

6. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

7. E. Norman Veasey, *The Defining Tension in Corporate Governance in America*, 52 BUS. LAW, 393, 403 (1997).

Section II of this article revisits the facts of the *Van Gorkom* case and examines the conduct of the major players. Section III focuses on the fiduciary duty of care owed by the board of directors to the corporation, in view of the business judgment rule and subsequent judicial review. Section IV analyzes the Act, as applied to the facts in *Van Gorkom*. Section V discusses some of the intricacies of the independent boards of directors. Whether the Act has added anything substantive to the fiduciary duty of care is debatable; however, weighing both the pros and cons of the Act, taking into account the fiduciary obligations of the boards of directors, would further elucidate the discussion.

II. CONDUCT OF THE BOARD OF DIRECTORS AND MANAGEMENT IN *VAN GORKOM*

The underlying problem in *Van Gorkom* concerned the corporation's inability to produce an adequate amount of taxable income to offset its surplus of investment tax credits ("ITCs")⁸ and the resulting actions by management and the board of directors.

The key players in the case were Jerome W. Van Gorkom ("Van Gorkom"), the Chief Executive Officer ("CEO") of the Trans Union corporation⁹; Jay A. Pritzker ("Pritzker"), a corporate takeover specialist; Donald Romans ("Romans"), Chief Financial Officer ("CFO") and top manager of the corporation; Bruce A. Chelberg ("Chelberg"), president of Trans Union; the board of directors which consisted of five inside¹⁰ and five outside directors¹¹, each of whom possessed substantial expertise; and James Brennan ("Brennan"), an attorney for Trans Union.

Trans Union was a publicly traded company that received its principal earnings from its railcar-leasing business, which generated a cash flow of hundreds of millions of dollars annually.¹² Unfortunately, the corporation was ineffective in generating sufficient taxable income to offset its ever-increasing ITCs.¹³ Consequently, Van Gorkom, in cooperation with other capital intensive firms, lobbied Congress to have

8. *Van Gorkom*, 488 A.2d at 864.

9. *Id.* at 865-66. "Van Gorkom, a certified Public accountant and lawyer, had been an officer for Trans Union for [twenty-four] years, its Chief Executive Officer for more than [seventeen] years, and Chairman of its board for [two] years." *Id.* at 865.

10. *Id.* at 894. "...the inside directors had collectively been employed for the corporation for 116 years and had 68 years of combined experience as directors." *Id.* at 894.

11. *Id.* The outside directors had [seventy-eight] years of combined experience as directors and as a group were employed with Trans Union for [fifty-three] years. *Id.*

12. *Id.* at 864.

13. *Id.*

ITCs refundable in cash to firms which could not fully make use of the credit.¹⁴ Their efforts failed, however.¹⁵

At a subsequent senior management meeting, Van Gorkom expressed his desire to find a more lasting solution to the problem, other than the corporation's recurrent practice of acquisition.¹⁶ Among the various alternatives discussed was the sale of Trans Union to a company that had a sizeable amount of taxable income.¹⁷ At this meeting, Romans, Trans Union's CFO, stated that his department had performed, at best, a tenuous forecast of the cash that the corporation could potentially realize in the event of a leveraged buy-out.¹⁸

At a later senior management meeting, the issue of a leveraged buy-out was further discussed as a possible strategic maneuver and as an alternative to the company's acquisition program.¹⁹ In preparation for this meeting, Romans and Chelberg, Trans Union's president, formulated rough calculations based on \$50 per share and at \$60 per share to determine the cash flow needed to service the debt that could result from a leveraged buy-out.²⁰ While these calculations were not intended to establish a fair price for the corporation or its entire stock, the figures indicated that a leveraged buy-out at \$50 per share would be fairly easy to accomplish but extremely difficult at \$60 per share.²¹ Although Van Gorkom expressed a willingness to take \$55 for his own

14. *Van Gorkom*, 488 A.2d at 864.

15. *See id.* at 864-65.

16. *Id.* at 865.

17. *See* CHARLES R.T. O'KELLEY & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS 108 (Teacher's Note 4th ed. 2003).

(1) Earning more pre-tax income against which to use its excess tax credits. This could be accomplished by "growing" the existing Trans Union business or by buying up smaller businesses that have excess taxable income;

(2) Finding a merger "partner" that had taxable income against which to offset the unusable tax credits;

(3) "Selling out" to a larger firm that had excess taxable income which it wished to have offset by Trans Union's tax credits;

(4) "Selling out" to a new set of managers who would then have the responsibility of solving the investment tax problem/opportunity.

Id.

18. *See Van Gorkom*, 488 A.2d at 865. Apparently, this work was propelled by a media article, which Romans had seen regarding a management leverage buy-out. *Id.* As Romans himself stated, the work consisted of a "preliminary study," and his analysis of the work was that it "was a very first and rough cut at seeing whether a cash flow would support what might be considered a high price for this type of transaction." *Id.*

19. *Id.*

20. *Id.*

21. *Id.* It is worth noting that these calculations were neither extensive nor conclusive, and were calculated without the benefit of experts. *Id.*

shares, he vetoed the proposed management buy-out, as it involved a potential conflict of interest.²²

Nonetheless, Van Gorkom privately contemplated whether it would be prudent for Trans Union to seek a privately or publicly-held purchaser.²³ He surreptitiously met with Jay Pritzker, a prominent corporate takeover specialist and social acquaintance, and proposed a \$55 per share price for the sale of Trans Union and a financing arrangement by which to complete the deal.²⁴ Van Gorkom consulted with neither the board members of Trans Union nor senior management, before meeting with Pritzker.²⁵ He did, however, meet with Trans Union's controller, Carl Peterson ("Peterson").²⁶ Van Gorkom instructed Peterson to calculate the practicability of a leveraged buy-out at \$55 per share, without providing any justification for his directive.²⁷ This figure was concocted by Van Gorkom, based exclusively on the availability of a leveraged buy-out, and unsupported by any competent evidence that \$55 represented the actual per share value of the company.²⁸ Pritzker later confirmed his interest in the \$55 cash-out merger proposal and met over the next two days with Van Gorkom to further discuss the proposed deal.²⁹

During their negotiations on the next day, Van Gorkom and Pritzker agreed upon a cash-out merger for one million shares of Trans Union treasury stock at a price of \$38 - 75 cents above the per share price at the close of the market on the following day.³⁰ Pritzker

22. *Id.* This would translate to \$133 million (\$75,000 x 55). And given that Van Gorkom was almost 65 years old at the time and ready to retire, this alternative presented a more attractive alternative to job preservation. *See id.* at 866. Also, at \$35 per share (the highest pre-merger agreement value in four years), Van Gorkom's shares were worth \$2,625,000. Therefore, if Trans Union was merged or sold at \$55 per share, Van Gorkom would have realized approximately \$1,500,000 more than he would have received at current market value. The issue of whether management is conflicted is based on the fact that the management's jobs may be at risk with a management buy-out. The real question is whether Van Gorkom was conflicted at all as, if a sale of some sort did not take place, he would be unable to recognize the greater value of his shares. Therefore, he would be conflicted. In other words it could be that the best route for Trans Union was to develop its inherent value in ways other than selling itself. On that decision, Van Gorkom may have been more interested in the value from an immediate sale than the shareholders would have been.

23. *Id.* at 866.

24. *Van Gorkom*, 488 A.2d at 866. Van Gorkom met with Pritzker at his home. *Id.*

25. *Id.*

26. *Id.* Van Gorkom told Peterson that he wanted no other person on his staff to know about the deal he arranged with Pritzker. *Id.*

27. *Id.*

28. *Id.*

29. *Id.* at 867. Chelberg, and Michael Carpenter, a Trans Union consultant, accompanied Van Gorkom to these meetings. *Id.*

30. *Van Gorkom*, 488 A.2d at 867. It is noteworthy that Van Gorkom and Pritzker had no further discussions on the previous price of \$55. *Id.*

demanded that Van Gorkom obtain approval of the proposed merger by Trans Union's board of directors within three days.³¹

Arrangements for bank financing were immediately made by Van Gorkom, Chelberg, and Pritzker.³² Van Gorkom also retained an attorney, James Brennan, to consult with Trans Union on the legal aspects of the merger.³³

In addition, Van Gorkom called a special meeting of the board for the following day, without providing notice that the purpose of the meeting was to discuss the proposed merger.³⁴ Van Gorkom also called a meeting of the company's senior management which was scheduled to convene one hour before the special meeting of the board.³⁵

In ascertaining whether the fiduciary duty of care required of Trans Union's board and management was upheld, and whether sound business judgment was exercised, the manner in which the special meeting of the board was conducted is of considerable significance. Therefore, a discussion of this meeting follows. The special meeting of the board extended over a two hour period.³⁶ During the meeting, the board was not provided with a copy of the merger agreement nor any other written documentation concerning the merger;³⁷ instead, its knowledge of the proposed merger was based entirely on a twenty minute presentation by Van Gorkom, during which time he outlined the terms of his offer to Pritzker.³⁸ In essence, upon selling all of its outstanding shares to Pritzker, for \$55 in cash, Trans Union would effectively merge into a new subsidiary that would be wholly owned by Pritzker.³⁹ It is noteworthy that Van Gorkom did not inform the board of how he arrived at the price of \$55.⁴⁰

31. *Id.*

32. *Id.*

33. *Id.* at 867. Van Gorkom did not consult with the head of Trans Union's legal department. *Id.*

34. *Id.*

35. *Id.*

36. *Van Gorkom*, 488 A.2d at 869.

37. *Id.* at 868. Copies of the proposed merger agreement were delivered too late for study before or during the meeting. *Id.*

38. *Id.* Van Gorkom discussed the problem with the depreciation deductions and ITCs. *Id.* He also disclosed his initial meeting with Pritzker and his offer for a merger buy-out. *Id.* However, he did not disclose that he proposed a price for the sale of Trans Union's shares to Pritzker. *Id.*

39. *Id.*

40. *See id.* at 869 n.9. In determining whether the \$55 price was a true appraisal of the value of the stock, an assessment of the market history of Trans Union's stock revealed that the merger price represented a premium of 62% over the average of the high and low prices that the stock

The proposed merger agreement also provided that Trans Union could receive, but not solicit, competing offers for a ninety day period.⁴¹ However, Pritzker had exclusivity of negotiation;⁴² therefore, inside information could not be furnished to other bidders.⁴³ Van Gorkom suggested that this period could serve as a market test and, for all intents and purposes, would determine whether the \$55 price represented a fair offer for the company's shares.⁴⁴

The merger agreement was also conditioned upon Pritzker obtaining the necessary financing within a stated period. Also, whether or not the merger was successful, Trans Union would be required to issue Pritzker a warrant for one million newly issued shares at the then-market price of \$38.⁴⁵

Van Gorkom argued that the issue before the board was not whether \$55 was the maximum amount that could be obtained for the shares, but whether \$55 was a fair price to be presented to the stockholders for their consideration.⁴⁶ Van Gorkom's position was supported by Chelberg, Trans Union's president, and Brennan, as legal counsel, advised the board that if the offer was rejected, Pritzker could sue, as a fairness opinion was not required.⁴⁷

Romans, who attended the meeting as CFO, informed the board that his study suggested that \$55 was a "rough" baseline for feasibility of a leveraged buy-out.⁴⁸ However, it was not indicative of a fair price for the stock or a valuation of the company.⁴⁹ He nevertheless considered the price to be fair.⁵⁰

traded for in 1980; a premium of 48% over the last closing price and 39% over the highest price at which the stock had traded at any time during the preceding six years. *Id.*

41. *See id.* at 868.

42. *Van Gorkom*, 488 A.2d at 868.

43. *Id.*

44. *Id.* Van Gorkom endorsed the position that putting Trans Union "up for auction" through a ninety-day market test would validate the position of the board that \$55 per share was a fair price. *Id.*

45. *Id.* at 867. In other words, if Pritzker's financial conditions were met or waived by Pritzker, Trans Union was required to sell to Pritzker one million newly-issued shares of Trans Union stock at \$38 per share.

46. *Id.* at 868. He told the board the free market would judge whether \$55 was fair price. *Id.* Van Gorkom claimed that, in short, all he was asking the board to do was approve the submission of the transaction to stockholders, who were the real decision makers. *Id.*

47. *Id.*

48. *Van Gorkom*, 488 A.2d at 868-69. Romans told the board that the studies he conducted at \$50 and \$60 were not intended to serve as the valuation of the company, but simply as the first step towards reaching a conclusion on the company's value. *Id.*

49. *Id.* at 869.

50. *Id.*

The merger agreement was executed by Van Gorkom and delivered to Pritzker,⁵¹ but was subsequently amended, due to threatened resignations by key officers of Trans Union.⁵² Van Gorkom also obtained board approval on the amendments.⁵³ However, the actual amendments to the merger agreement, which were prepared by Pritzker, diverged significantly from Van Gorkom's representation of the amendments to the board.⁵⁴ In spite of this, Van Gorkom executed the amendments to the agreement.⁵⁵

After the buy-out was consummated, Trans Union's disgruntled shareholders brought a class action suit originally seeking rescission of the cash-out merger of Trans Union and alternate relief in the form of damages.⁵⁶

The main issue in this case was whether the board of directors acted with due care for the corporation and were hence protected by the business judgment rule.

III. THE DUTY OF CARE AND THE BUSINESS JUDGMENT RULE

Because the business and affairs of a company are generally managed by or under the direction of the company's directors, there is a threshold standard expected from directors in carrying out these responsibilities, which consists of two basic functions: a decision-making function and an oversight function.⁵⁷ The latter generally involves the formulation of corporate policy and strategic corporate goals, while the former concerns periodic attention to corporate systems and controls, policy issues, or any matter necessitating a director's inquiry.⁵⁸

51. *Id.* This took place at a formal social event organized by Van Gorkom. *Id.* Neither he nor any other director read the agreement prior to its signing and delivery to Pritzker. *Id.*

52. *Id.*

53. *Id.* at 869. The amendments made it virtually impossible for Trans Union's board of directors to negotiate a better deal and withdraw from the merger agreement.

54. *Van Gorkom*, 488 A.2d at 869. Van Gorkom signed the amendments without informing the board of the discrepancies between his representations of the agreement and the actual agreement and the resulting implications.

55. *Id.*

56. *Id.* at 863-64. This was a class action suit as opposed to a derivative suit. A derivative suit is generally brought by the shareholders on behalf of the company. Hence, the true plaintiff in a derivative suit is the company that has been wronged by the Board's failure to act with requisite care and diligence. In this case, the shareholders have suffered a loss of their status as shareholders of Trans Union, due to the board's failure to act with due care. *Id.* The shareholders thus sought damages against the board, the subsidiary, New T, and its owners. *Id.*

57. The general threshold standard is that every director must discharge his duties in good faith and in a manner the director reasonably believes to be in the best interest of the corporation. Florence Shu-Acquaye, *The Taxonomy of the Director's Fiduciary Duty of Care: United States and Cameroon*, 22 N.Y.L. SCH. J. INT. & COMP. L. 585, 592 n.31, n.32 (2003).

58. For more discussion, see Florence Shu-Acquaye. See *Corporate Director's Guidebook*, 56 BUS. LAW. 1571, 1578-84 (3d ed. 2001).

In carrying out their duties, directors are expected to act in good faith, in the best interest of the corporation, and with the care that a person in a similar position would reasonably believe appropriate.⁵⁹ In managing the affairs of the company, directors therefore owe a duty of care to the company and its stakeholders. In some states, the fiduciary duty of care is defined by judicial doctrine, whereas in other states, the statutory formulations replace or supplement the common law.⁶⁰ For those states that have adopted the Model Business Corporation Act, Section 8.30 delineates the standards of conduct for directors by concentrating on the manner in which they perform their duties and the level of performance expected of them in managing the business dealings of the corporation.⁶¹

In addition to their continuing duty to supervise and monitor the affairs of the corporation, directors are also responsible for making important business decisions. Courts invoke the business judgment rule in assessing the conduct of directors and determining whether to impose liability in a particular case.⁶² The business judgment rule, as a standard of judicial review, is the common law recognition of the statutory authority that has been vested in the board of directors.⁶³

What exactly is the business judgment rule? It is a presumption of regularity that the decisions of boards of directors are made after an informed and reasonable investigation, in good faith, and with the honest belief that the decisions were made with the best interest of the corporation in mind.⁶⁴

Although, the business judgment rule is designed to foster the complete exercise of managerial power granted to directors, it is not an

59. MODEL BUS. CORP. ACT § 8.30 cmt. (1998); *see also* Shu-Acuaye, *supra* note 57, at 592.

60. Under Delaware law, the business and affairs of a Delaware corporation are managed by or under its board of directors. DEL. CODE ANN. tit. 8, § 141(a) (2003). *See also* MODEL BUS. CORP. ACT. § 8.30(b) (1998) (stating that “members of the board. . . shall discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances”). This standard is often characterized as a duty of care. *See* MODEL BUS. CORP. ACT § 8.30 cmt. (1998). *See also* Shu-Acuaye, *supra* note 57, at 592.

61. Directors are expected to perform their duties in “good faith” and in a manner reasonably believed to be in the corporation’s best interest. MODEL BUS. CORP. ACT § 8.30 cmt. (1998).

62. MODEL BUS. CORP. ACT § 8.30 cmt. (1998).

63. *MM Companies, Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1127 (Del. 2003).

64. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (*overruled on other grounds*). The business judgment rule serves as a shield which protects directors from liability for their decisions. *O’KELLEY & THOMPSON*, *supra* note 17, at 285. Where it is found that the directors should receive protection of the rule, the courts would not interfere with or second guess the directors’ decision. *Id.* If the directors are found to not be entitled to the protection of the business judgment rule, the courts would then scrutinize the directors’ decision to determine whether it was intrinsically fair to the corporation and its shareholders. *Id.*

unfettered power.⁶⁵ Application of the business judgment rule is based on a demonstration that informed directors did in fact make a business judgment sanctioning the matter being examined.⁶⁶ A director's obligation to inform himself, in preparation for his decision, derives from the fiduciary capacity in which he serves the company and its stakeholders.⁶⁷ Therefore, whether the directors' business judgment was informed is determined by whether they took the necessary steps to inform themselves of all material and relevant issues, prior to making the business decision.⁶⁸ Once this presumption is established, the decision of the board is protected from judicial review of the merits.⁶⁹

Generally, courts are reluctant to second-guess the board's decisions, as judges do not necessarily possess the business expertise and skill of the board.⁷⁰ However, recent corporate scandals, as well as the latest case decisions in Delaware, suggest that courts have heightened their review of director's conduct thereby putting into question the validity of the business judgment rule.⁷¹

In *Brehm v. Eiser*, after reiterating the traditional formulation of the business judgment rule, the Delaware Supreme Court stated that "the concept of substantive due care is foreign to the business judgment rule" and that "directors' decisions will be respected by courts unless the directors are interested or lack independence relative to the decision" or fail to consider material facts.⁷²

The Delaware Chancery Court recently denied a motion to dismiss an amended complaint against a board of directors arising from the

65. See generally *Van Gorkom*, 488 A.2d at 871.

66. *Kaplan v. Centex Corp.*, 284 A.2d 119, 124 (Del. Ch. 1971).

67. *Lutz v. Boas*, 171 A.2d 381 (Del. Ch. 1961).

68. *Aronson*, 473 A.2d at 812.

69. See R. Franklin Balotti & Joseph Hinsey IV, *Director Care, Conduct and Liability*, 56 BUS. LAW. 35, 37 (2000).

70. See *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996) (*arguing against substantive judicial review of the board*); see also *Shu-Acquaye*, *supra* note 56, at 593. This reluctance was also expressed in *Joy v. North*, 692 F.2d 880, 886 (Conn. 1982). There are certain circumstances, however, which mandate that a court take a more direct and active role in overseeing the decisions made and actions taken by the directors. Under such circumstances, the court subjects the directors' conduct to enhanced scrutiny to ensure that it is reasonable, before the protection of the business judgment rule may be conferred. See *UNOCAL Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985). See also WILLIAM A. KLEIN ET AL., *BUSINESS ASSOCIATIONS* 36 (5th ed. 2004).

71. Over the past year, the Delaware Supreme Court has reversed Chancery Court decisions in favor of defendant directors in the following cases: *MM Companies, Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118 (Del. 2003); *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914 (Del. 2003); *Levco Alternative Fund Ltd. v. Reader's Digest Ass'n*, 803 A.2d 428 (Del. 2002); *Saito v. McKesson HBOC, Inc.*, 806 A.2d 113 (Del. 2002); *Telxon Corp. v. Meyerson*, 802 A.2d 257 (Del. 2002).

72. *Brehm v. Eisner*, 746 A.2d 244, 264 n.66 (Del. 2000) (quoting *Aronson*, 473 A.2d at 812).

same issue in *Brehm* that underlay the court's interpretation of the business judgment rule.⁷³ Although the Chancellor noted that it was rare for courts to impose liability on directors for breach of the duty of care, this was found not to be the case where the directors "failed to exercise *any* business judgment and failed to make *any* good faith attempt to fulfill their fiduciary duties to [the company] and its stockholders."⁷⁴ The court further concluded that the alleged facts suggested that the directors "*consciously and intentionally disregarded their responsibilities*, adopting a 'we don't care about the risks' attitude concerning a material corporate decision."⁷⁵ Hence, the demand was excused and the complaint was found sufficient to withstand the motion.⁷⁶

Similarly, in a Seventh Circuit case, *In re Abbott Laboratories Derivative Shareholders Litig.*, the court held that the directors' decision to not act was not made in good faith, where they were aware that the company had failed to comply with various safety regulations and took no action.⁷⁷

Likewise, the Delaware Chancery Court found that a special litigation committee, appointed by the corporation's board, was influenced by considerations other than the best interest of the corporation in concluding that the directors did not breach their duty to the corporation.⁷⁸

Whether the former treatment of the business judgment rule is on the decline is questionable. However, the prevailing trend, in recent decisions, is that a heightened level of judicial scrutiny will be applied to the conduct of directors in managing the affairs of the company. Therefore, in order for directors to lessen the likelihood of assuming

73. *In re The Walt Disney Co. Derivative Litig.*, 825 A.2d 275, 291 (Del. Ch. 2003).

74. *Id.* at 278.

75. *Id.* at 289.

76. *Id.* at 289-90.

77. *In re Abbott Laboratories Derivative Shareholders Litig.*, 325 F.3d 795, 809 (7th Cir. 2003).

78. *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 948 (Del. Ch. 2003). A special litigation committee (SLC), comprised of independent directors, was appointed by the corporation's board to determine whether a shareholder derivative action should proceed for allegations made that the CEO and other directors of the Oracle Corporation breached their duties to the corporation by engaging in insider trading. *Id.* at 923. The SLC moved to dismiss the derivative litigation. *Id.* at 928. The Delaware Chancery Court noted that a personal relationship existed between the SLC members and the defendants. *Id.* at 942. Also, the decision of the SLC was probably motivated by economic interests; specifically, a \$50,000.00 gift from one of the defendants to a SLC member for delivering a speech at the defendant's request, and the possibility that a \$170 million donation would be made to the university where both SLC members taught by the corporation. *Id.* at 943. The court concluded that the SLC's decision was motivated by material considerations other than the corporation's best interest. *Id.* at 947.

an increased risk of liability, they must be vigilant in demonstrating good faith and informed decision-making.⁷⁹

In *Van Gorkom*, the lower court concluded that the board's approval of the merger fell within the protection of the business judgment rule because sufficient time and consideration were given to the proposal.⁸⁰ The court's decision was based on its finding that the board deliberated over the proposed merger on three separate occasions.⁸¹ In short, the lower court propounded that Trans Union's board acted neither "recklessly" nor "improvidently" in determining the course of action it deemed best for the corporation.⁸² However, on appeal, the Supreme Court of Delaware reached a different conclusion.

The standard of review utilized by the Delaware Supreme Court involves an analysis of the complete record and a formulation of distinct findings of fact, where appropriate.⁸³ In carrying out its power of review, the function of the Supreme Court is to assess the competency of the evidence and to test the suitability of the lower court's findings.⁸⁴ If the facts are adequately substantiated by the evidence and are the result of an organized and logical deductive process, the decision of the lower court stands untouched.⁸⁵ This is the case even where the Supreme Court would have otherwise reached a contrary conclusion;⁸⁶ the Supreme Court would only thus reach a conflicting decision, when the findings below are undeniably incorrect and necessitates a judicious reversal.⁸⁷

As discussed earlier, substantial deference is given to boards in administering the business and affairs of a corporation.⁸⁸ However, the

79. See Meredith M. Brown & William D. Regner, *What's Happening to the Business Judgment Rule?*, 17 *INSIGHTS* 2 (2003). For instance, the directors should focus and decide on important matters, identify and minimize conflict of interest, act on an informed basis, and rely on experts when appropriate. *Id.*

80. *Van Gorkom*, 488 A.2d at 870. Consideration was given to the merger agreement on September 20, 1980, October 8, 1980, and January 26, 1981. *Id.* The lower court, therefore, ruled that in light of the market value of Trans Union's stock, the business acumen of the board, the significant premium over market offered for the stock, and the ultimate effect on the merger price by prospective bids for the stock, the board's action in reaching its decision on the merger agreement was both efficient and controlled. *Id.* at 870-71.

81. *Id.* at 870.

82. *Id.*

83. *Id.* at 871.

84. *Id.*

85. *Id.*

86. *Van Gorkom*, 488 A.2d at 871.

87. *Id.*

88. See, e.g., DEL. CODE ANN. tit. 8, § 141(a) (2003); *Pogostin v. Rice*, 480 A.2d 619, 624 (Del. 1984); *Aronson*, 473 A.2d at 805, 811; *Zapada v. Maldonado*, 430 A.2d 779, 782 (Del. 1981).

board's power is not unfettered.⁸⁹ Therefore, in measuring the actions taken by Trans Union's board, in its approval of the merger agreement, it is therefore necessary to first determine the legal governing standard that the court considered in reviewing the conduct and practices of the board.

Principally, the governing legal standard is a demonstration that the board upheld its fiduciary duty of care to the corporation and its stockholders.⁹⁰ This obligation is protected by the business judgment rule, provided that the board acted on an informed basis, in good faith, and in the honest belief that its actions were made in the best interest of the corporation.⁹¹

A business judgment will be considered to be informed when it can be shown that the directors educated themselves of all material facts before rendering a business decision.⁹² In other words, a board's due care to the corporation and its shareholders is paramount. Consequently, the business judgment rule does not afford protection to directors who exercised "unintelligent" or "unadvised judgment,"⁹³ or who submitted to "faithlessness, fraud, or self-dealing."⁹⁴

These latter conditions were not found in *Van Gorkom*.⁹⁵ The court also stated that the fulfillment of the fiduciary duty requires more than the mere absence of fraud, bad faith, or self-dealing (a breach of the duty of loyalty).⁹⁶ Instead, a duty of care must prevail.

The court further conceded that, in prior cases, various terms were used to explicate the applicable standard of care,⁹⁷ but nevertheless concluded that, under the business judgment rule, a board's liability is based on the theory of gross negligence.⁹⁸ The court also reasoned that the appropriate standard for determining whether a business judgment was informed hinges upon concepts of gross negligence.⁹⁹

89. See generally *Van Gorkom*, 488 A.2d at 871.

90. *Id.* at 872.

91. Aronson, 473 A.2d at 812; see also Kaplan, 284 A.2d at 124.

92. Kaplan, 284 A.2d at 124.

93. *Mitchell v. Highland-Western Glass Co.*, 167 A. 831, 833 (Del. Ch. 1933). The court in this case asked the question of whether the board acted "so far without information that they can be said to have passed an unintelligent and unadvised judgment." *Id.* See also *Gimbel v. Signal Companies, Inc.*, 316 A.2d 599, 615 (Del. Ch. 1974), *aff'd per curiam*, 316 A.2d 619 (Del. 1974).

94. *Van Gorkom*, 488 A.2d at 872.

95. *Id.* at 873.

96. *Id.* at 872.

97. Compare *Mitchell*, 167 A. at 833 (indicating that the standard is whether the board passed an unintelligent and unadvised judgment), with *Gimbel*, 316 A.2d at 619 (describing the standard as a finding that the board acted "without the bounds of reason and recklessly" in reaching its business decision).

98. *Van Gorkom*, 488 A.2d at 873.

99. *Id.*

Did the directors' actions measure up against this standard, as a matter of law? In order to answer this question, one must consider the actions of the board in making its decision on the merger agreement.

By plotting some of the sign posts referenced in the decision, it can be shown that the directors failed to act with informed and reasonable deliberation.¹⁰⁰ To illustrate this point, the directors were grossly negligent in approving the cash-out sale of the corporation after having deliberated for only two hours, without prior notice of the proposal, and without being provided with some basis for the existence of an emergency.¹⁰¹ The board was also presumably negligent in failing to obtain any documentation concerning the proposed merger agreement¹⁰² despite insufficient evidence of its terms, outside of Van Gorkom's two hour oral presentation.¹⁰³ In addition, the board acted negligently in not obtaining sufficient documentation to support Van Gorkom's representation of the value of the corporation.¹⁰⁴

Moreover, directors may not overcome the presumption that they negligently agreed to the valuation of the company¹⁰⁵ by relying on their collective experience with the company¹⁰⁶ and on the fact that the price represented a substantial premium over the prevailing and historical market prices.¹⁰⁷

100. The court summarily concluded that the board did not reach an informed business judgment in voting to sell the company for \$55 per share pursuant to the cash-out merger proposal as follows: (1) the directors did not adequately inform themselves of Van Gorkom's role in forcing the sale of the corporation and in determining the per share purchase price; (2) the directors also failed to inform themselves of the intrinsic value of the corporation; and (3) the directors approved the "sale" of the corporation after two hours' consideration, with no notice given of the proposed "sale," and with no suggestion that an emergency or crisis existed. *Van Gorkom*, 488 A.2d at 874.

101. *Van Gorkom*, 488 A.2d at 874.

102. *Id.* The directors had nothing before them other than Van Gorkom's statement of his understanding of the substance of the agreement, which he admitted to having never read. *Id.* Directors should insist on recesses to obtain adequate information, rather than deciding without the benefit of such information.

103. *Id.*

104. *See id.* The directors were given no documentation to support the adequacy of the fifty-five dollars price per share for the company. *Id.*

105. Adequate documentation of the value of the company could have easily been obtained by simply asking the company's chief financial officer to conduct a valuation study. Alternatively, the board could have commissioned an outside valuation study.

106. *Van Gorkom*, 488 A.2d at 875.

107. *Id.* The directors argued, *inter alia*, that the board's decision was informed because of the magnitude of the premium difference between the \$55 Pritzker offer and Trans Union's current market price of \$38 per share, and that the adequacy of the premium was conclusively established by the market over a 90 to 120 days period. *Id.* at 875, 878. This argument was rejected by the court because, even though a substantial premium could potentially provide some basis for the suggestion of a merger, with the absence of sufficient documentation to support the actual

Also, the outside directors did not involve their inside management or outside investment bankers, who generally propose such mergers and related transactions, and who were familiar with the internal affairs of the corporation, prior to authorizing the merger agreement.¹⁰⁸ This does not mean that, as a matter of law, the board is required to obtain a fairness opinion by outside investment specialists.¹⁰⁹ However, given the fact that the Trans Union board also failed to request that its CFO conduct a valuation study or, at minimum, review the proposed merger agreement, the board lacked sufficient evidence that its authorization of the agreement was informed, such that it could make a sound business judgment.¹¹⁰

The court also questioned the efficacy and utility of the market test which was proposed as an estimation of the value of the corporation.¹¹¹ Although the market test was not a requisite of an assertion that the directors exercised good business judgment, they were none-

value of the company, a premium by itself is inadequate justification for its proposed value. *Id.* at 875. Also, there was no evidence to support a finding that the merger agreement was effectively amended to give the board the option to put the company up for auction sale to the highest bidder, or indeed that an auction was likely to occur. *Id.* at 877.

The court also rejected the board's purported reliance on a study conducted by a consultant group (BCG study) and a Five Year Forecast in support of the adequacy of the \$55 per share price because the board made no reference to these studies in any of its meetings in which the merger agreement was addressed. *Id.* at 875. Also, these studies were not an adequate representation of a customary valuation study. *Id.* In addition, the board was aware that the market had consistently underestimated the value of Trans Union's stock. *Id.* at 876.

108. This failure is even more significant because none of the directors, management, or outside directors were investment bankers or financial analysts. In view of this, the meeting in which the cash-out merger was authorized should have been recessed to permit them an opportunity to obtain additional information from inside management (Romans, CFO) concerning the adequacy of the offer or from the company's investment bankers (Soloman Brothers) whose merger and acquisitions specialist was well known to the board and who was familiar with the company's affairs. *Id.* at 877. Also, directors who, in the performance of their duties for the company, rely in good faith on records and reports of their officers, managers, independent certified public accountants, and appraisers are fully protected. DEL. CODE ANN. tit. 8, § 141(a) (2003).

109. The court concluded that an outside valuation study was not essential to support a finding that the board made an informed business judgment. *Van Gorkom*, 488 A.2d at 876. In addition, fairness opinions by independent investment bankers are not required as a matter of law. *Id.*

110. The board, besides failing to realize that Van Gorkom had suggested the \$55 price to Pritzker, also did not realize that the price was based on calculations that were designed solely to determine the feasibility of a leverage buyout. *Van Gorkom*, 488 A.2d at 877. Accordingly, the court reasoned that had the directors made an inquiry of their CFO of the particulars of his valuation study, it would have been duly informed that the study merely offered a rough calculation of the company's value and was not determinative of its fair value and therefore was inadequate. *Id.*

111. *Van Gorkom*, 488 A.2d at 878.

theless required to ensure that the test was neither deceptive nor disingenuous.¹¹²

In light of the foregoing, the court held that the directors breached their fiduciary duty of care to the company and stockholders by failing to inform themselves of all material information in determining whether to approve the merger agreement.¹¹³ The court also concluded that the board of directors' approval of the merger agreement was uninformed as it lacked sufficient valuation information to reach an informed business judgment on the fairness of the proposed merger cash-out.¹¹⁴ Accordingly, the directors' decision did not fall under the protection of the business judgment rule.

The question then turns to, what would the results be when a board is stripped of the protection afforded to it under the business judgment rule? Once the business judgment rule presumption is pierced, upon a showing that the directors breached their fiduciary duty of care,¹¹⁵ the burden of proof shifts to the board of directors. The board of directors must then demonstrate that the decision was intrinsically fair to the company and therefore warranted protection.

In other words, the board must meet the two-part "fairness test" delineated in *Weinburger v. UOP, Inc.*¹¹⁶ *The first prong of the "fairness test" is a demonstration that the transaction was the result of fair dealings by the board of directors.*¹¹⁷ *The second element is met, if it is*

112. Van Gorkom argued that even though the merger agreement incorporated a market test component, it nonetheless precluded the company from actively soliciting such offers and from providing any further information about the company to interested parties. *Van Gorkom*, 488 A.2d at 878-89. It was also the contention of the directors that they believed the entire financial community would be informed of the sale of the company, once the proposed cash-out merger was announced. *Id.* In addition, several of the outside directors maintained that they understood the agreement to mean that if they obtained a better offer, they were within their right to accept it. *Id.* However, the court found that because the merger agreement did not give the board the right to put the company up for auction, nor was the agreement amended to permit a market test and the right to accept a better offer, the director's reliance on the market test as the basis for accepting the merger agreement was unfounded. *Id.*

113. *Van Gorkom*, 488 A.2d at 880.

114. At no time did the board request a valuation study, taking into consideration the company's assets. *Van Gorkom*, 488 A.2d at 877. Neither did the board take time to review the proposal. *Id.* Additionally, the board accepted, without question, Van Gorkom's representation as to the fairness of the fifty-five dollar price. *Id.*

115. After the *Van Gorkom* decision, such breach includes a showing that the directors made an important decision without being adequately informed.

116. *Weinburger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983).

117. *Id.* at 711. Fair dealing encompasses questions of when the transaction was timed; how it was initiated; how the negotiated was structured; the manner in which the transaction was disclosed to the directors; and how the approval of the directors and shareholders was obtained. *Id.* Whereas fair price deals with the economic and financial considerations of the proposed merger, including such relevant factors as the market value of the assets, future earnings prospectus, and

*shown that a fair price was obtained.*¹¹⁸ As illustrated above, the board in Van Gorkom failed to satisfy both prongs of the fairness test.¹¹⁹

The dissent gave deference to the judgment and experience of the directors, however.¹²⁰ They argued that due regard should be given to both the inside and outside directors because of the magnitude and extent of their business experience and the length of their cumulative service with Trans Union.¹²¹ The dissent also maintained that the inside directors were well qualified and collectively could not have been taken in by a "fast shuffle,"¹²² and further that the dissent also contended that, because the directors were sufficiently informed of the business and affairs of Trans Union, they were more than adequately qualified to make a quick business judgment concerning the sale of the corporation.¹²³

Whether Van Gorkom could have been taken in by a "fast shuffle" is debatable. However, the court found that the collective experience and expertise of the directors was undermined by their failure to make a reasonable and informed decision on the proposed merger.¹²⁴ This factor purportedly calls for even stricter scrutiny in today's boards, especially given the fact that significant emphasis is placed on the director's stature. This contention is further developed in the discussion below on the impact of the Act. Even so, the court concluded that the competence and sophistication of Trans Union's directors was overshadowed by astounding evidence of their gross negligence in approving the merger agreement.

any other factor that could affect the intrinsic value of the company's stocks. O'KELLEY & THOMPSON, *supra* note 17, at 258. (Emphasis added.)

118. *Weinburger*, 457 A.2d at 711. (Emphasis added.)

119. There was no fair dealing as the directors arrived at the decision to sell the corporation without any due diligence. Likewise, the price was not fair because an actual market test would have been a better measure of market value than an appraisal of the company's worth.

120. *Van Gorkom*, 488 A.2d at 894.

121. *Id.* The five inside directors had collectively been employed by Trans Union for 116 years and had 68 years combined experience as directors. *Id.* The five outside directors were considered comparably competent with them having 78 years of combined experience as chief executive officers and 53 years of cumulative service as Trans Union directors. *Id.*

122. *Id.* The dissent pointed out that "directors of this caliber were not ordinarily taken in by a 'fast shuffle.'" *Id.* Also, directors of this business acumen and expertise were completely cognizant of the state of affairs, especially as it pertained to the entire corporate appraisal of Trans Union. *Id.*

123. *Id.* at 895. The dissent contended that the corporate world operates on a "fast track," conditions to which the Trans Union directors had become accustomed. *Id.*

124. *Id.* at 880. The court found that the directors' reasons for accepting the proposal was undermined by Van Gorkom's contention that the director's collective experience and sophistication was a sufficient basis for finding that the board reached its decision with informed, reasonable deliberation. *Id.*

The Supreme Court remanded the case for a determination of the fair value of the shares, based on the intrinsic value of Trans Union at the time the cash-out merger was approved, as well as an award in damages.¹²⁵ It has been argued that the more appropriate measure of the value of the stock was its market value, the price that would have been eventuated from an open auction.¹²⁶ This posture was taken because there was no other bid for the Trans Union stock higher than that of the cash-out merger offer. The court was therefore forced to conclude that the measure of damages was that price that the directors would have been able to extract if the board had done its job properly.¹²⁷ For example, if the intrinsic value of the company was found to be \$65 per share, the directors' liability would have been \$133,577,580. Given this risk, the directors settled the case by agreeing to pay a mere \$23,500,000; most of which was paid by the corporation's insurers and the Pritzker group.

IV. THE AFTERMATH OF THE DECISION IN *VAN GORKOM*

The *Van Gorkom* decision sent shockwaves through corporate America. Its ramifications impacted the potential effect of serving on corporate boards,¹²⁸ due to directors' heightened vulnerability to liability for breach of the fiduciary duty of care.¹²⁹ Also, in the aftermath of the decision, premiums for directors and officers have sharply increased.¹³⁰ Further, many legislatures have enacted exculpation provisions that limit and sometimes eliminate directors' liability for breach of the fiduciary duty of care. Beginning with Delaware in 1986,¹³¹ over forty states have such provisions. The following sets

125. Why remand with instructions for a hearing on damages, rather than instructions to first hold a hearing to determine whether the defendants could carry their burden of proving the transaction's entire fairness? As shown above, the transaction was neither fair to the corporation; nor was there fair dealing. Hence, the only issue to remand to the lower court was the amount of damages to be accessed. CHARLES R.T. O'KELLEY & ROBERT B. THOMPSON, *CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS* 258 (4th ed. 2003).

126. Bayless Manning, *Reflections and Practical Tips on Life in the Boardroom After Van Gorkom*, 41 *BUS. LAW.* 1, 4 (1985).

127. *Id.*

128. Following the decision, directors were reluctant to serve on boards. Also, even where they chose to serve, they were overly cautious out of fear of being sued. This is an issue which invariably may impact the value of the stockholder.

129. The protection provided by the business judgment rule was lessened, whereas, the risk of unnecessary interference or second-guessing of directors' judgments was increased.

130. Manning, *supra* note 127, at 6. The availability of directors' and officers' insurance was curtailed as insurers dropped out of the field and policies were canceled. *Id.* Consequently, the shortage of insurers meant an exodus of independent directors from corporate boards. *Id.*

131. The Delaware statute is also known as the charter option statute, which authorizes corporations to adopt such provisions in its certificates of incorporation. See O'KELLEY & THOMPSON,

forth both the Delaware and the Revised Model Business Corporation Act ("RMBCA") provisions.

Section 102 of the Delaware statute, with some exceptions, eliminates or limits the personal liability of directors for monetary damages for breach of their fiduciary duty of care to the corporation or its stockholders.¹³² This provision does not, however, cover liability for breach of the duty of loyalty, acts or omissions that were not made in good faith, or which involves intentional misconduct or violation of the law, or transactions from which the director derived an improper personal benefit.

Based on this issue, one would expect that stockholders would avoid investing in companies incorporated in Delaware if the statute actually protects directors from liability. This has not been the case, however. Such may be the result because investors simply do in fact condone some negligence from the board.

In this same vein, in 1990, the American Bar Association Committee on Corporate Governance incorporated exculpation provisions in section 2.02 of the RMBCA.¹³³ In contrast to the Delaware statute, the RMBCA also covers directors' liability for breach of the duty of loyalty.¹³⁴

V. THE SARBANES-OXLEY ACT, THE NEW YORK STOCK EXCHANGE RULES AND IMPACT OF THE ACT

The stock market crash of the late 1990s, compounded by the relentless spread of financial fraud found in many large public corporations, prompted a need for corporations to rethink corporate governance policies in this country.¹³⁵ As a result of the incidence of

supra note 17, at 252. The effect of the provision is to allow shareholders to remove breach of duty of care as a cause of action for damages. *See id.*

132. DEL. CODE ANN. tit. 8, § 102 (b)(7) (2004).

133. REV. MODEL BUS. CORP. ACT § 2.02(b)(4) (2001).

134. *Id.* What may not be covered (exceptions) by the charter option statute is what distinguishes many of the statutes from each other. But the Delaware statute and that of fifteen other states contain the following exceptions: 1) breach of the duty of loyalty to the corporation or the stockholder; 2) acts or omissions not in good faith; 3) intentional misconduct; 4) knowing violation of the law; 5) improper distribution; and 6) any transaction from which the director derived an improper personal benefit. REV. MODEL BUS. CORP. ACT § 2.02(b)(4) cmt. (2001).

135. "Sarbanes-Oxley and the proposed NYSE listing standard amendments are intended to prevent future corporate abuses and corruption. But the reforms served a more immediate purpose than promoting good corporate governance. Beyond the merits of specific proposals, a strong regulatory response was needed to boost investor confidence. Simply by doing something, Congress and the NYSE showed that there was a cop on the block and that fraud and corporate corruption would not be tolerated." Troy A. Parades, *Enron: The Board, Corporate Governor, and Some Thoughts on the Role of Congress*, in ENRON: CORPORATE FIASCOS AND THEIR IMPLICATIONS 519 (Nancy Rapport & Bala Zharin, eds., Foundation Press 2004). Others

fraud, affected shareholders and employees encountered massive losses.

Also, the unforeseen and shocking demise of companies, such as Enron, Adelphia Communications, WorldCom, Quest, and a few others, propelled Congress to approve the SEC's recommendation to pass the Act of 2002 as a means to boost investors' confidence.¹³⁶ Sections of the Act that are applicable to this discussion are outlined below.

One of the major innovations of the Act was the creation of a Public Company Accounting Oversight Board ("Oversight Board") which oversees audits of public companies that are subject to the securities laws. The principle purpose of the Oversight Board is to protect the interests of investors, and to engage public interest in the preparation of informative, accurate, and independent audit reports.¹³⁷

The duty of directors to be informed is covered under section 301 of the Act. As discussed earlier, corporate law imposes upon directors a duty of care, which manifests itself in the form of a monitoring function and stems from the principle that all corporate affairs must be managed under the direction of the board of directors.¹³⁸ This monitoring function involves different and overlapping duties, including the board's reliance in good faith on others in the corporation. Hence, a board's duty to remain informed is satisfied by its reliance on officers and agents of the corporation,¹³⁹ as well as its assiduous review of specific transactions.

While such may be the case under the Act, this did not occur with the board in *Van Gorkom*.¹⁴⁰ Consequently, the court found that the

have said that the Sarbanes-Oxley Act and the SEC regulations do provide new structure but were simply a political reaction to give assurance to the public that the problems had been fixed. William Ide, *Post-Enron Corporate Governance Opportunities: Creating a Culture of Greater Board Collaboration and Oversight*, 54 MERCER L. REV. 829, 832 (2003). Hence, the primary focus was on what was required to comply with the law and nothing more. *Id.*

136. The Act has been said to be unprecedented, because "in addition to regulating disclosure and securities trading, the traditional jurisdiction of U.S. federal securities laws, the Act also addresses matters of substantive corporate governance and executive fiduciary responsibility. . . ." Michael H. Hein et al., *The Sarbanes-Oxley Act of 2002 Effects Sweeping Changes to the U.S. Federal Securities Laws*, GT ALERT (Greenberg Traurig, LLP), Aug. 2002, at 1. These duties have historically been viewed as a prerogative of the states and self regulatory organizations (SRO). *Id.*

137. MELVIN ARON EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS, 2004: STATUTES, RULES, MATERIALS, AND FORMS, 1970 (2004).

138. SHU-ACQUAYE, *supra* note 57, at 585, 592.

139. DEL. CODE ANN. tit. 8, § 102 (e) (2004); MODEL BUS. CORP. ACT § 8.42(b) (1998).

140. *Van Gorkom*, 488 A.2d at 875-81. The directors' defense that they also relied on the advice of their counsel, Brennan, who informed them that they could be sued if they did not go through with the transaction, did not exculpate the board. *Id.* The reason for this is that reliance

board's general familiarity with the company's financial condition did not provide a sufficient basis for its approval of the cash-out merger.¹⁴¹ In view of this, *Van Gorkom* reveals that generalized knowledge is not enough to satisfy a board's duty to remain informed.

Even so, in the absence of gross negligence (business judgment rule threshold), courts are generally reluctant to find directors in breach of their duty of care, and the approach adopted to determine whether a board has breached its duty of care has been relatively relaxed.¹⁴² Simply put, because of the business judgment rule presumption that board action is a product of good faith and should therefore be protected, unless the action is grossly egregious, the court's tendency is to not interfere with or second guess a board's decision; the result is a fairly lax standard of review. In fact, several studies have confirmed this to be the trend in corporate America.¹⁴³

Has the Act changed this lax standard? On the one hand, the Act seems to validate the requisite duty to be informed.¹⁴⁴ This is evidenced by the condition that the board is required to sign the company's annual report. The Act's requirement for a board to remain informed, regarding accounting information, is also consistent with cases like *Van Gorkom*, which require directors to obtain appropriate information prior to making a business decision.¹⁴⁵ To that extent, the Act does not add anything new to the customary standard of review.

in good faith does not mean blind reliance. *Id.* Rather, a reasonable basis for their reliance is required. *Id.* The argument about the test conducted by Romans was also rejected on similar basis. *Id.*

141. See Lisa Fairfax, *The Sarbanes-Oxley Act as Confirmation of Recent Trends in Director and Officer Fiduciary Obligations*, 76 ST. JOHN'S L. REV. 953, 961 (2002). *Van Gorkom* suggests that corporate officials are not at liberty to supplant reliance for their own knowledge.

142. *Id.* at 960.

143. *Id.* "The foundation stone of the American law of corporate governance is currently enunciated in the holdings (not the dicta) of the leading corporate states: there must be a minimum of interference by the courts in internal corporate affairs. Except in the egregious case of bad judgment or when there is evidence of bad faith, courts have made no attempts to second-guess directors on the substantive soundness of decision reached." *Id.* (citing Charles Hansen, *The ALI Corporate Governance Project: Of the Duty of Care and the Business Judgment Rule*, 41 BUS. LAW. 1237, 1239 (1986). Likewise, in "[t]he search for cases in which directors of industrial corporations have been held liable in derivative actions for negligence uncomplicated by self-dealing is a search for a very small number of needles in a very large haystack." FAIRFAX, *supra* note 142, at 960 n.38 (quoting Joseph W. Bishop, Jr., *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078, 1099 (1968)).

144. Section 302 requires the CEO and CFO of a public company, in their quarterly and annual report to guarantee the accuracy of the report, and to certify the accuracy of the company's financial statement, and that the company has adopted adequate internal controls. See PARADES, *supra* note 134, at 516.

145. Likewise, in *Francis v. United Jersey Bank*, 432 A.2d 814 (N.J. 1981), Mrs. Prichard and her two sons were shareholders and directors of a reinsurance brokerage business. *Id.* at 818.

On the other hand, in contrast to the conventional standard, section 301 of the Act clearly adds content to the director's duty to remain informed. For example, the board of directors is required, through its audit committee, to appoint and oversee the work of the accounting firm employed by the corporation.¹⁴⁶ Also, in connection with its oversight function, the audit committee is responsible for resolving disagreements between management and the auditor regarding financial reporting. This responsibility for resolving disputes ensures that the directors, who serve on the audit committee, take an active role in the auditing process.¹⁴⁷ As a result, their knowledge about the process and the company is enhanced, which heightens the content requirement of the duty to be informed.¹⁴⁸ Given this, it appears that mere reliance on other agents, or the excuse that one is not a specialist would not constitute sufficient compliance with the Act's requirements.

The Boards' responsibility to oversee public accounting firms also suggests that directors have an affirmative duty to keep abreast of financial information. Likewise, under section 302 of the Act, which generally deals with Corporate Responsibility for Financial Reports, section 302 (a)(4), (A) and (B) require executive officers to establish and maintain internal controls to ensure that material information is made known to officers. This means that a laissez-fair attitude towards corporate affairs is no longer tolerated; the CEO and CFO must certify the effectiveness of the internal control procedures.

In this regard, the Act appears to provide fiduciary-like requirements for executives and thus more weight to the general duty to be informed under the statutes and case law.¹⁴⁹ Therefore, in light of the Act's requirement that officers take responsibility for implementing and maintaining internal controls, it could be argued that the Act has evolved a step further than case law.¹⁵⁰

After the death of her husband, she became depressed and drank a lot, and basically paid no attention to the business. *Id.* at 819-20. As a result the sons squandered and misappropriated over 12 million dollars. *See id.* at 818-19. The court held she was in breach of her fiduciary duty of care for failing to inquire and monitor the company. *Id.* at 829. Hence, if directors do not have sufficient knowledge to make an informed decision, they should refuse to act or resign their position.

146. *See generally* Sarbanes-Oxley Act of 2002 § 301.

147. *See* FAIRFAX, *supra* note 142, at 961.

148. *See id.*

149. *Id.* at 962.

150. *Id.* at 963. That such a corporate responsibility was rejected in the Delaware Supreme Court case of *Graham v Allis-Chalmers Manufacturing Co.*, 188 A.2d 125 (Del. 1963) (holding that the officers of a corporation did not have an obligation to implement a system of watchfulness).

Then again, the decision *In re Caremark Int'l, Inc. Derivative Litigation*, long ago established this general rule.¹⁵¹ Because of this, it could be said that it is really not an innovation under the Act after all.¹⁵²

Whatever one might conclude, the Act is applicable to all publicly traded corporations and is not limited to a particular jurisdiction, as the decision in *Chalmers* has made clear. Accordingly, a broader application of the rule is effectuated. In this light, the board in *Van Gorkom* would have found it even more difficult to defend its position that it made an informed business decision, based upon its reliance on material information afforded through its internal controls.

Also, in determining what impact, if any, the Act would have had on the *Van Gorkom* decision, the general applicability of section 305 of the Act must also be considered. Section 305 expands the SEC's ability to remove directors and officers and bar them from serving in similar capacities at other public companies by demonstrating their "unfitness."¹⁵³ Unfortunately, the proscription from serving as an officer or director is far-reaching, and fails to distinguish between behaviors that might rise to a finite-term suspension and those that should give rise to a lifetime bar.¹⁵⁴

The core question then becomes, "to what extent did the director's or officer's conduct fall outside the norms of professional conduct?"¹⁵⁵ In considering this question, the degree of harm that resulted and the level of contempt the director exhibited for the interests of the com-

151. 698 A.2d 959 (Del. Ch. 1996)

152. In speaking about the duty to remain informed and interpreting *Allis-Chalmers*, the Delaware Court of Chancery found that "corporate boards [cannot] satisfy their obligation to be reasonably informed. . . without assuring themselves that information and reporting systems exist in the organization that are reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation's compliance with law and its business performance." *In re Caremark*, 698 A.2d at 970. See also FAIRFAX, *supra* note 142, at 971 (noting that the court today would not accept the formulation of *Allis-Chalmers* because the courts now require more exacting standards).

153. The Act does not define what unfitness is and the legislative history of the Act provides no guidance either. Jayne W. Barnard, *SEC Debarment of Officers and Directors After Sarbanes-Oxley*, 59 BUS. LAW. 391, 408 (2004). The prior standard required "substantial unfitness." *Id.* It is also not clear from the legislative history that the change in language from "substantial unfitness" to "unfitness" was intended to reduce the quantum of proof required of the government. *Id.* However, it has been propounded that it is more difficult to determine that someone is "unfit" than it is to determine that the person is "substantially unfit;" in the same way it is easier for a litigant to show substantial compliance with a statute than to show strict compliance. *Id.*

154. Would it have been clearer if Congress delineated one standard of misconduct for suspension and a higher standard of misconduct for lifetime bar? See generally *id.* at 412 for a discussion of this issue.

155. *Id.* at 410.

pany's investors is measured.¹⁵⁶ Also, a determination is made concerning the director's or officer's ability to rehabilitate.¹⁵⁷

In *Van Gorkom*, Romans, the CFO of Trans Union, was vehement in his objection to the merger,¹⁵⁸ but he voted for it anyway.¹⁵⁹ Had he not voted and the minutes reflected his objection, would he have been excused then and now under the Act? It appears from the court's decision that Romans might have been excused, because the court alluded to the fact that the directors took a unified position and therefore were all liable. This implicitly means that had he distanced himself from the decision by making a strong argument against the merger, as well as voted against it, he might have been exonerated.

Romans also might have been exonerated under the Act, if his objection was noted and he did not vote to pass the resolution. In that instance, he probably would not have been deemed unfit to serve on the board of other public companies; his conduct about the market test was far from clandestine.

However, today, it is more likely that Trans Union would have complied with section 406 of the Act. This section directs the SEC to adopt rules requiring a public company to disclose if it has adopted a code of ethics for its senior financial officers or to explain why it had not done so and to disclose immediately any waiver of or change in the code of ethics.¹⁶⁰ Under those circumstances, it is highly probable that Trans Union would have forced Roman's hand to conform to the ethical obligations circumscribed under the Act.

Conversely, neither Van Gorkom nor the other board members could have been exonerated either then or now under the Act. Inter-

156. *Id.*

157. *Id.* Barnard also proposed that the courts, in making that determination, should consider: "(i) whether the defendant had an understanding of the fiduciary role of an officer or director; (ii) whether there is reason to believe that she is unable to perform that role professionally and responsibly in a setting other than the setting in which her prior misconduct occurred; (iii) whether she has expressed contrition for past misconduct and whether that expression is credible; and (iv) whether carefully-drawn limitations, such as a prohibition against participating in the preparation of financial documents or communicating with analysts or the public, might serve to ensure that, if the defendant is hired as an officer or director, future misconduct will not recur." *Id.*

158. *Van Gorkom*, 488 A.2d at 884-85. Also, Romans and other senior management officials were responsible for soliciting an alternate offer/ proposal (from KKR) for Trans Union to compete with Pritzker's offer. *Id.* As expected, Van Gorkom was very unwelcoming to the proposal. *Id.* Likewise, GE Credit Corporation's interests in Trans Union never blossomed into a formal offer, due to the unwillingness of Pritzker to extend the February 10th deadline for Trans Union's stockholders' meeting. *Id.*

159. *Id.*

160. My assumption here, of course is that he would still have the desire to object to the consummation of such a merger based on fulfilling his ethical obligations.

twined with the duty to be informed is the duty of inquiry. The duty to inquire is triggered when:¹⁶¹ a) corporate officials have knowledge that a wrong doing has occurred; b) they have responsibility for approving specific documents; and c) during major corporate transactions.¹⁶²

The *Van Gorkom* board failed to pose pertinent questions to Van Gorkom and the other executives.¹⁶³ Given the magnitude of the decision and the absence of substantial information related to that decision, the board's duty of inquiry was especially critical in this case. A twenty minutes deliberation, prior to voting, could not have afforded the board sufficient time to adequately deal with issues that should have been raised earlier. This, of course, called into question the degree of good faith the board exercised. Also, the board's conduct was extremely far removed from the norms of professional conduct and contemptuous to the company's shareholders. Therefore, under the Act, each of the board members most likely would have been considered unfit to serve on the board of other public companies.¹⁶⁴

The dissent opined, that based solely on the their collective experience and sophistication, the board should not have been held liable.¹⁶⁵ The dissent reasoned that the directors' level of experience alone was a sufficient basis for them to reach their decision after an informed and reasonable deliberation; directors of their caliber were not ordinarily taken by a "fast shuffle".¹⁶⁶

We also know from the composition of the Enron board, who had comparable talents and expertise,¹⁶⁷ that the stature of the board and its executives is not a basis to free them from negligent decisions or failure to inquire. To that extent, the board would be disqualified from serving on other boards due to their unfitness. As *Van Gorkom*

161. Note that Sarbanes-Oxley does not specifically impose upon management a duty to inquire; this is however implicit in the Act itself.

162. FAIRFAX, *supra* note 142, at 972.

163. See *Van Gorkom*, 488 A.2d at 893.

164. Even when an attempt was made to amend the September 20th merger agreement, to allow for competing bids, Pritzker presented the supposed amendment to Van Gorkom on October 10th, which Van Gorkom proceeded to countersign (alone) on behalf of Trans Union. *Van Gorkom*, 488 A.2d at 833. Although Trans Union's board eventually approved the amended version on a much later date (December 20th, the record did not appear to affirmatively establish that Trans Union's directors ever read the amendments. *Id.*

165. *Van Gorkom*, 488 A.2d at 894-98.

166. *Id.* at 895.

167. The Enron board was comprised of a wide range of very qualified individuals with backgrounds from business, finance, accounting and government. See PARADES, *supra* note 136, at 504 (providing a list and qualifications of Enron's directors in 2001). Also, the company had all the committees one would want to see in a company of that kind. See *id.*

and Enron suggest, exceptionally good board structuring does not necessarily guarantee good results.

a. *The Inside versus Outside Directors:*

The *Van Gorkom* court suggested that directors may very well have different litigation exposure. For example, outside directors might not be liable for a board's decision if they were misled by inside directors about the advisability of a decision that shareholders alleged was made negligently. Inside directors often have better information and are generally more knowledgeable about the business of the company than outside directors. Also, because they typically have more at stake, inside directors have a greater incentive to ensure the company's success.¹⁶⁸

The *Van Gorkom* decision also makes clear that, if directors take a unified position in litigating a case, the court may properly treat the directors as a unit and ignore possible distinctions between those directors who might otherwise have been considered loyal to the company. Hence, the court's judgment was blurred concerning whether the outside directors in *Van Gorkom* should have been treated differently. In effect, the court sought to drive a wedge between directors who were negligent or disloyal and those who were not.¹⁶⁹

b. *Board Independence*

Within the last twenty years in this country, there has been an increasing trend towards more outside directors on corporate boards of directors, which is expected to result in a decreased proportion of insiders on boards.¹⁷⁰ The trend towards fewer inside directors was sparked by the inclination to make boards more independent from management.¹⁷¹ Both the Act and the NYSE have fostered the notion of more independent boardmembers through a mandatory board composition requirement.¹⁷² Is this requirement likely to enhance corporate governance?

168. Although the converse is that insiders have a greater stake in the company, this makes them more vulnerable to "cook the books." See generally PARADES, *supra* note 136, at 520.

169. CHARLES R.T. O'KELLEY & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS 109 (Teachers ed. 1999).

170. Proxy statement data for 1998 shows that corporate boards of public corporations in the United States average eleven directors, with two inside directors. See Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 SAN DIEGO L. REV. 781, 787 (2003).

171. *Id.* at 788.

172. In late May early June of 2002, NASDAQ and NYSE both announced they would be making recommendations to their respective boards of directors to adopt additional corporate governance listing standards. See IDE, *supra* note 136, at 845. NASDAQ's rules were primarily

Section 301 of the Act requires that NYSE and NASDAQ listed companies have an audit committee¹⁷³ comprised solely of independent directors.¹⁷⁴ In order for a director to be considered independent, he or she may not receive any fees from the company, other than a director or committee fee, or otherwise be an affiliated person of the company or any of its subsidiaries.¹⁷⁵

The NYSE has substantively regulated corporate governance through its listing standards. After Enron and the other corporate scandals, the NYSE proposed extensive amendments to its listing standards which would effectively augment its regulatory authority over corporate boards of directors.¹⁷⁶ The proposed amendments would require that the board of directors of companies listed on the NYSE be primarily comprised of independent directors. A more stringent definition of what constitutes an independent director was also proposed. In order for a director to be "independent," the director cannot have a "material relationship" with the company, which includes commercial, industrial, banking, consulting, legal, accounting, charitable, or familial relationships.¹⁷⁷ Additional restrictions are also imposed upon directors who seek status as an independent.¹⁷⁸ Given

limited to addressing shareholder approval of stock option plans, a restrictive definition of independence, and audit committee approval of related party transactions. *Id.* NYSE, on the other hand, took a more definitive first step of publishing its Recommendations of its Corporate Accountability and Listing Standards on June 6, 2002. *Id.* at 845-46.

I am however, only discussing the NYSE standard listings. Following the signing of the Sarbanes-Oxley Act into law by the President, on July 30, 2002, NASDAQ & NYSE took additional steps to ensure that their proposed listing standards did not conflict with the provisions of the Act. *Id.* at 850. In NASDAQ's case, the standards were expanded to include additional and more comprehensive proposals that were more in line with NYSE proposals. *Id.*

173. The number of public companies that now have audit committees that are composed of outside directors illustrates the increasing focus on manager monitoring by U.S. boards. A 1998 proxy statement revealed that all public corporations have audit committees with an average of zero insiders on these committees. DALLAS, *supra* note 170, at 789. The audit committee is intended to implement and support the boards' manager-monitoring function. *Id.*

174. Sarbanes-Oxley Act of 2002 § 301.

175. *Id.*

176. See PARADES, *supra* note 136, at n.26. See Corporate Governance Rule Proposals Reflecting Recommendations from NYSE Corporate Accountability and Listing Standards Committee as Approved by The New York Stock Exchange Board of Directors August 1, 2002 (No. SR -NYSE-2002-33, filed Aug. 16, 2002).

177. See PARADES, *supra* note 136, at n.26.

178. *Id.* (1) Receives, or has an immediate family member who receives, more than \$100,000 per year in compensation from the company, other than director and committee fees and pension or other forms of deferred compensation; (2) is affiliated with or employed by, or has an immediate family member who is affiliated with or employed in a professional capacity by, a present or former internal or external auditor of the company; (3) is employed, or has an immediate family member who is employed, as an executive officer of another company where any of the listed company's present executives serves on the other company's compensation committee; or (4) is an executive officer or an employee, or has an immediate family member who is an

these extensive constraints, it is questionable whether there are any directors who currently serve on the board of companies thus listed who would qualify as an independent director.

The proposed amendments also require that regular meetings of the independent directors occur outside the presence of management directors.¹⁷⁹ Also, independent directors would receive independent compensation and shareholder approval would be required for equity-based compensation plans.¹⁸⁰ The amendments also propose that independent directors maintain separate nominating and audit committees.¹⁸¹ The proposed amendments also make it mandatory for independent directors to establish corporate governance guidelines and codes of conduct.¹⁸²

Rather than discuss the merits of the proposed amendments as it relates to independent directors, the pros and cons of an independent board of directors will be discussed.

c. *Concerns with the Independent Board Requirement*

The regulations are quite inexorable and treat all companies and all boards as if they were alike; while a "one size fits all" approach was adopted in practice, in effect distinct differences result, simply because not all boards and companies are the same.

The role of a board of directors is basically threefold; there is a monitoring role, managerial role, and resource role. Different companies have different needs and the function that a board will be required to perform, from time to time, varies from company to company.¹⁸³ Consequently, in subjecting all public companies to the requirements proposed by the amendments, the most efficient outcome may not result.

Perhaps, instead of both Congress and NYSE making the rules mandatory,¹⁸⁴ they could, alternatively, adopt a set of default rules,

executive officer, of another company (a) that accounts for at least two percent or \$1 million, whichever is greater, of the listed company's consolidated gross revenues or (b) for which the listed company accounts for a least two percent or \$1 million, whichever is greater, of the other company's consolidated gross revenues. *Id.* In no event will a current employee of the company be considered independent. *Id.*

179. See IDE, *supra* note 136, at n.64 (citing New York Stock Exchange, Corporate Account Corporate Accountability and Listing Standards Committee Report (June 6, 2002)).

180. *Id.*

181. *Id.*

182. *Id.*

183. PARADES, *supra* note 136, at 520.

184. Most corporate governance commentators recommend that a board of directors of a public company should be composed of a substantial majority of independent directors. In referring to director's independence, the committee emphasized that deference should be given to a

which would give corporations an ability to opt out—even if doing so would require a supermajority vote of shareholders.¹⁸⁵

At the end of the day, the director's independence equates to the director's state of mind and willingness to act objectively and stand up against management. Thus, as has been suggested, the true test of a director's independence is whether she is willing to resign if need be.¹⁸⁶

In requiring that a board be comprised of more independent directors and by tightening the definition of "independent," the pool of potential directors has been substantially narrowed. This could have the effect of compromising the board in all of its duties. Also, the NYSE definition of "independent director" seems to have made it virtually impossible to find the right person who does not have some affiliation with the company that would disqualify him or her. As a result, the limited pool of choices does not make the position competitive enough. Hence, the best qualified persons may be qualified in form rather than in substance. This is a compromise which the board may, at some point, have to pay for.

Moreover, although monitoring is quintessential for successful corporate governance, too much monitoring may deprive the board of a degree of collegiality, openness, and trust. As directors become more independent, they are likely to become more adversarial vis-à-vis top managers and each other.¹⁸⁷ At the same time, active board oversight could make management too risk adverse. Likewise, an aggressive monitoring board might deter qualified people from serving as officers of public corporations. However, if other monitoring devices were present, such as market pressures, or active (institutional) shareholder bases, then an active monitoring board becomes less important.¹⁸⁸

In order for monitoring to be effective, the focus should be on the independence of the board's chairperson or lead directors; this is because board leadership by independent directors could have a positive

broader judicial standard of disinterestedness that will be applied by a court in review. See *Corporate Director's Guidebook*, 59 BUS. LAW. 1057, 1101 (4th ed. 2004). Therefore, the wide range of business and personal relationships between potential director and the corporation, as well as its senior managers, would be taken into consideration. See *id.*

185. See PARADES, *supra* note 136, at 536. Even if an independent board is the answer, the definition of independence in the Sarbanes-Oxley Act and the proposed listing standards is problematic, because the definition of independent has been expanded to cover certain financial and business ties that in the past were not understood as compromising a director's independence.

186. PARADES, *supra* note 136, at 522.

187. "Constructive tension" is good for business, but animosity and distrust are not. PARADES, *supra* note 136, at 521.

188. PARADES, *supra* note 136, at 521.

effect on the social dynamics of the board.¹⁸⁹ The genuine question then becomes whether independent directors are truly independent.¹⁹⁰ Notwithstanding this, the danger of placing too much power in the hands of one person, whether or not he or she is independent, should not be undermined. Generally, the power broker is an individual who is the CEO and or chairman of a company.

It is also noteworthy that the "independent" character or nature of a person has little, if anything, to do with her role as an independent director. For example, Enron's CEO, Jeff Skilling, was described by an officer of the company as ". . . a creature of his own creation who had become more intolerant, more opinionated, more bombastic, who was always right, and got worse; he had a little bit of God syndrome."¹⁹¹

Also, even though independent boards of directors are desirable and are now even more recommended, it has been argued that the independence of outside directors is diminished when they serve on boards with inside directors.¹⁹² Studies show a correlation between the capacity to exert influence and one's position in a hierarchical social structure. Similarly, psychological studies on group behavior indicate that members of a group operate under social pressures that encourage conformity to the group, or a lack of objectivity.¹⁹³ Therefore, being "independent," in the true sense of the word, makes it trite to say that the socialization process of board members, as well as the influence generally exerted by the CEO over the board, denies directors true independence.

Moreover, a director who holds multiple directorships, and who also serves as an executive officer on another company's board, may not wish to be monitored as scrupulously in his position as executive officer. This factor could potentially compromise the director's ability to effectively monitor the governance of the company.

VI. CONCLUSION

In conclusion, the foregoing discussion weighed some of the pros and cons of the Act with deference given to the *Van Gorkom* case.

189. DALLAS, *supra* note 170, at 792-93. A 1999 survey of public corporations showed that only 9% of responding corporations had independent director chairpersons, 30% had lead directors and the rest of the corporations had no plans to implement either of the two. *Id.* at 793.

190. In Enron, for example, it turned out that many of the outside directors were not independent, as they were benefiting from various kinds of financial relationships with Enron. See DALLAS, *supra* note 170, at 794.

191. See DALLAS, *supra* note 170, at 817.

192. See *id.* at 787-88.

193. *Id.* at 804.

In general, the Act has the advantage of boosting investors' confidence. More importantly, the Act represents positive development in corporate governance; it validates trends that impose more stringent obligations on corporate managers by providing exacting standards of conduct.¹⁹⁴ Because the Act contains severe criminal sanctions and other provisions for directors and officers who violate their fiduciary obligations to the company and its stakeholders, the Act may serve to deter violations of the fiduciary duty of care and thereby enhance corporate governance as a whole.¹⁹⁵ In outlining the manner in which control mechanisms should be developed, the Act also highlights how corporate managers could satisfy their obligations.¹⁹⁶

On the other hand, some argue that the Act simply mimics existing case law and, therefore, does not add anything substantively new to the fiduciary duty owed by directors.¹⁹⁷ Additionally, the Act is a "one size fits all" rule which fails to consider that companies are different and their needs vary. Therefore, the Act may not be as effective as it should be in accomplishing its main objective.

Furthermore, the Act encroaches upon the states' power to regulate corporations registered within its jurisdictions; the Act creates the impression that it is nothing more than a back door approach to federally regulate corporate governance in this country. In other words, the Act marks an expanded role for Congress to substantively regulate corporate governance in the United States.¹⁹⁸ Although corporate governance has been the province of state law which is subject to public scrutiny under the disclosure requirements of the federal securities laws, parts of the Act and the SEC regulations are helpful additions to the disclosure requirements. However, other parts are said to be cumbersome intrusions into areas in which state law has greater expertise and abilities.¹⁹⁹ The rationale that state law should govern stems from the fact that "corporations are creatures of state law" and states have traditionally regulated this area.²⁰⁰

Only time will tell whether the regulatory response is a permanent solution to governance problems as it relates to the fiduciary duty of

194. See generally FAIRFAX, *supra* note 142, at 977.

195. Section 906 imposes a \$1 million fine, 10 years in prison, or both for persons who knowingly violate the certification requirement and a \$5 million fine, 20 years in prison or both for willful violation of provision. Sarbanes-Oxley Act of 2002 § 906.

196. FAIRFAX, *supra* note 142, at 977.

197. *Id.*

198. PARADES, *supra* note 136, at 531.

199. *IDE*, *supra* note 136, at 834.

200. PARADES, *supra* note 136, at 533.

company directors.²⁰¹ Nevertheless, one thing that is certain is that some kind of congressional response to corporate scandals is better than no response at all.

201. As one author said, the “new regulatory and legislative reforms may be based upon the mistaken belief that imperfect governments may be remedied. . .time will tell if the measures enacted to address corporate governance deficiencies have not themselves created corporate governance inefficiencies. . .” John F. Olson & Michael T. Adams, *Composing a Balanced and Effective Board to Meet New Governance Mandates*, 59 BUS. LAW. 421, 451 (2004).